

All Community Builders
 All Multifamily Hub Directors
 All Multifamily Program Center Directors
 All Project Managers
 All Secretary's Representatives
 Contract Administrators, Owners and Managers
 of Projects with Expiring Section 8 Contracts

Project-based Section 8 Contracts Expiring in Fiscal
 Year 2000

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I. BACKGROUND

The Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA), Title V of the HUD Fiscal Year 1998 Appropriations Act, Pub. L. 105-65, enacted October 27, 1997, established new policies for the renewal of Section 8 project-based contracts based on market rents. For most projects with rents above market, the Act transferred processing and oversight functions from the Multifamily Hubs and Program Centers to the new Office of Multifamily Housing Assistance Restructuring (OMHAR).

In general, MAHRA required that expiring Section 8 project-based contracts be renewed under Section 524(a)(1) or 524(a)(2).

- Section 524(a)(1) renewals required a Rent Comparability Study (RCS).

If the RCS indicated rents at or below comparable market rents, the contract was renewed at current rents, unless the Owner submitted documentation justifying a budget-based rent increase. In no case could renewal rents exceed comparable market rents.

If the RCS indicated rents above comparable market rents, the contract was referred to OMHAR for debt restructuring and/or rent reduction.

- Section 524(a)(2) renewals were for projects identified as "exception" projects that were not eligible to be referred to OMHAR (no RCS was required except under 524(a)(2)(E)).

These requirements are discussed in detail in HUD's Interim Rule for Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark-To-Market) and Renewal of Expiring Section 8 Project-Based Assistance Contracts, published in the Federal Register on September 11, 1998, at 63 FR 48925.

On October 16, 1998, HUD published Housing Notice H 98-34 which provided instructions for renewing Section 8 contracts expiring in FY 1999. On May 27, 1999, HUD published Housing Notice H 99-08 which made several modifications to H 98-34. On June 16, 1999, HUD published Housing Notice H 99-15 which implemented the Mark-Up-To-

Market Option for Owners of projects with expiring Section 8 contracts.

The Preserving Affordable Housing for Senior Citizens and Families Into the 21st Century Act of 1999, Titles II and V of the HUD Fiscal Year 2000 Appropriations Act, Pub. L. 106-74, enacted on October 20, 1999, made some modifications to the previous Section 8 renewal policies, and established specific provisions for rent adjustments in subsequent years after an initial renewal under MAHRA.

This Notice provides instructions for renewing Section 8 contracts expiring in FY 2000. While Section 8 renewal policy remains substantially similar to the policy already in place, the major changes from FY 1999 renewal policies are highlighted in Section III below. Because of changes to MAHRA, all references to renewing contracts under Sections 524(a)(1) and 524(a)(2) are no longer accurate. In FY 2000, six options are available to Owners of projects with expiring contracts. These options are explained in Section VII of this Notice.

This Notice is the comprehensive policy for Section 8 project-based contract renewals in FY 2000 and incorporates the procedures contained in previous Housing Notices. Therefore, the following Notices are no longer in effect:

- H 98-34 published on October 16, 1998, which provided instructions for renewing Section 8 contracts expiring in FY 1999.
- H 99-08 published on May 27, 1999, which made several modifications to H 98-34.
- H 99-15 published on June 16, 1999, which implemented the Emergency Mark-Up-To-Market Initiative for certain projects with expiring Section 8 contracts.
- H 99-25 published on September 22, 1999, which extended Notices H 98-34 and H 99-08.
- H 99-32 published December 1, 1999, which clarified existing policies.

II. PURPOSE

This Notice provides instructions for renewing Section 8 project-based assistance contracts (or stages) expiring in FY 2000. It:

- A. Provides guidance to Owners, management agents, contract administrators and HUD staff on:
 - 1. Renewing contracts, including the combination of multiple stages and/or multiple contracts;
 - 2. Setting initial renewal rents and handling annual rent increases at subsequent renewals; and
 - 3. The requirements and procedures for opting-out of a Section 8 project-based contract.
- B. Advises Owners to submit their option selection (Attachment 4) to HUD **120 days** before expiration of the contract, rather than the previous 90 days.
- C. Defines Owners' notification responsibilities regarding:
 - 1. Contract expiration/termination;
 - 2. Prepayment notification for Emergency Low-Income Housing Preservation Act (ELIPHA) and Low-Income Housing Preservation and Resident Home Ownership Act (LIHPRHA) projects; and
 - 3. Intent to Opt out of the Section 8 program.

III. FY 2000 POLICY CHANGES

The following are highlights of the differences between the FY 1999 and FY 2000 renewal policies. These highlights are explained in greater detail throughout the body of this Notice.

- A. Section 524(a) replaces Section 524(a)(1) and now provides general Section 8 expiring contract renewal authority. It:
 - 1. Provides the renewal authority for what had been the "Emergency Initiative" implemented by HUD Notice H 99-15, which in FY 2000 is Option 1,

Mark-Up-To-Market Procedure. ***It is generally the same policy as in FY 1999, except that non-profit transfers are now eligible for Mark-Up-To-Market, even if the property does not meet the standard eligibility criteria.*** (See Section IX)

2. Is the authority for renewing other contracts with current rents that are at or below comparable market rents. In general, rents at initial renewal will be determined by applying an OCAF to current rents, or if the Owner requests, a budget-based adjustment. This is a change from last year, when below-market contracts generally were renewed at current rents without an OCAF adjustment. In no case may initial renewal rents under 524(a) exceed comparable market rents. (See Section X)
 3. Permits non-profit Owners to mark rents up to a budget-based level, not to exceed comparable market rent, to perform capital repairs on the project, an option that was not available last year. (See Section XXII)
 4. In general, requires that contracts with current rents above market rents must be referred to OMHAR for processing. (See Section XI)
- B. Section 524(b) now provides the authority to renew projects exempted from OMHAR. The major change, other than the change in Section cite from 524(a)(2) to 524(b), is that in FY 2000, FHA insured properties that are State or locally financed may be eligible for the Mark-To-Market program, and will be referred to OMHAR for processing. (See Section XII)
- C. Section 524(c) provides general authority to adjust rents at subsequent renewal by:
1. OCAF; or,
 2. Upon the request of the Owner, a budget basis which, in some cases, will be limited to comparable market rents.

(See Sections IX, X and XII)

NOTE: There are exceptions to the general rules stated in Section 524 (a) through (c). Where applicable, these exceptions are noted in this Notice.

- D. The new law states that OCAFs established by HUD shall not result in a negative rent adjustment.
- E. In accordance with 24 CFR 402.2, in FY 1999, MAHRA required Owners of contracts that renewed under Section 524(a)(1) to submit a RCS with their request for contract renewal. Future rent increases were to be by application of an OCAF, but not to exceed comparable market rents. The regulation reserved to HUD the right to re-determine rents on the budget-based method from time to time. The FY 2000 Act changed this to make automatic OCAF adjustments for four years after initial renewal, unless the Owner requests a budget-based rent increase. In the fifth year, the Owner must submit a new RCS in order to ensure contract rents do not exceed market rents.

For Owners who wish to combine contracts or request a budget-based increase, the RCS submitted at initial renewal can be used for any contract or stage that expires during the five year term of the RCS, but to do so, the RCS must include all of the Section 8 units in the project (not just the units in the expiring Section 8 contract). (See Attachments 4 and 6 and Section VIII)

Note: The five year cycle for each RCS starts with the initial renewal of the Section 8 project-based contract under MAHRA. This includes contracts renewed in FY 1999 and Portfolio Reengineering Demonstration contracts.

The law also gives HUD the right to request one updated RCS at any time during the five year period.

- F. The new law authorizes an "enhanced" voucher instead of a "standard" voucher for an eligible family living in an assisted unit when a Section 8 contract expires. If the contract is terminated, eligible families will continue to receive a standard voucher. (See Section XV)
- G. The new law allows Preservation projects with contracts expiring to renew under the provisions outlined in the approved Plan of Action (POA), even if these rents

exceed market. Additionally, such projects are no longer eligible for Mark-to-Market.

1. Preservation projects will receive all of the benefits called for in the POA.
2. In FY 2000, Preservation Section 8 contracts, by statute, cannot be renewed for more than one year.

H. Portfolio Reengineering Demonstration Projects:

Projects that went through the Portfolio Reengineering Demonstration Program will renew the Section 8 contract in one of the following ways:

1. Projects that went through the Portfolio Reengineering Demonstration Program and had their mortgages restructured and/or had rents reduced to market should not be forwarded to OMHAR. They should be renewed as follows:
 - a. Annually for the four years after the Demonstration Contract was signed, the contract will receive an OCAF adjustment.
 - b. At the end of the fifth year, the project must follow the procedures outlined in Section X (option 2) of this Notice. This includes having to complete a RCS.
 2. If the mortgage was not restructured and the project's rents were not reduced to market, the Owner must submit a rationale as to why debt restructuring is inappropriate. The rationale and the renewal request should be submitted to Headquarters, Office of Portfolio Management, attention Frank Malone.
- I. HUD now has the authority to renew contracts for any term, subject to appropriations. Generally, renewals should be for either one year or five years. However, HUD will permit terms ranging from less than one year to more than five years in certain situations. (See Section VI)
- J. The FY 2000 Appropriations Act amended Section 8(c)(8) of the U. S. Housing Act of 1937 to provide for a uniform one-year notification requirement for contract expiration or termination. See Section XVI for further

discussion. Revised notification letters are provided in Attachment 3.

- K. If an Owner of an expiring Section 8 contract requests a contract renewal, and it is determined that he/she or an affiliate is a suspended or debarred Owner, HUD may permit the Owner to renew the Section 8 contract if the project(s) in question is(are) adequately managed and maintained, and activities at the project(s) were not the cause of the administrative actions against the Owner.
- L. Under certain circumstances, a budget-based rent increase will be permitted during the term of a Section 524 contract. These rent increases are "other rent increases." (See Section XXIII)
- M. When a Contract Administrator is administering the Section 8 contract, a HUD signature is no longer required on the "PHA as Contract Administrator" contract form.

IV. APPLICABILITY

- A. This Notice applies to all Multifamily Housing Projects with project-based Section 8 assistance contracts expiring in FY 2000, unless otherwise noted.
 - 1. It does not apply to Moderate Rehabilitation projects administered by the Office of Public and Indian Housing or to any projects administered by the Office of Community Planning and Development.
 - 2. Until a project has a contract or stage of a contract that is expiring, project Owners and Field staff should follow the procedures in place when the contract was executed.
- B. This Notice does not provide detailed instructions regarding OMHAR's Mark-To-Market Program. For detailed information on restructuring:
 - 1. Contact the OMHAR staff at 202-708-0001.
 - 2. You can also access Mark-To-Market information on the web at:

<http://www.hud.gov/omhar>.

V. INITIAL AND SUBSEQUENT RENEWALS

Two years ago Congress made major changes to the Section 8 project-based renewal process. As a requirement for renewal under Section 524(a)(1) of MAHRA, project Owners with expiring Section 8 project-based contracts had to submit a RCS to demonstrate that current rents were at or below comparable market rents. In FY 2000, most Owners are still required, at the initial renewal stage, to submit a RCS to establish that the contract rents are at or below comparable market rents.

The FY 2000 Act states that, beginning with the date of the initial renewal of an expiring Section 8 project-based contract, the RCS will start a five-year "life cycle" before a new RCS is required. During the five-year life cycle, all subsequent renewals of the first contract and renewals of other Section 8 project-based contracts or stages will not require a new RCS.

- A. An "Initial Renewal" is the first renewal of a project's contract or stage that is processed under the rules established by MAHRA.
- B. A "Subsequent Renewal" is the renewal of an expiring Section 524 contract at the end of its term. A contract that received its initial renewal in FY 1999 under Section 524(a)(1) or 524(a)(2) of MAHRA, will receive its subsequent renewal in FY 2000 under the procedures outlined in this Notice.
 - 1. Projects are eligible to apply for Mark-up-to-Market at any expiration, not just at initial renewal.
 - 2. Staged contracts that were not combined and are expiring for the first time in FY 2000 may use the RCS submitted at the initial renewal, if the RCS included all of the Section 8 units in the project.
- C. Initial and Subsequent renewals have separate processing instructions.
 - 1. Field Office staff and Contract Administrators should check the Owner's Attachment 4 submission to see which option the Owner selected.

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2. Based on the option selected by the Owner, refer to the table of contents to see how to process the request.

VI. CONTRACT TERMS AND EFFECTIVE DATES

In FY 1999, only contracts that renewed under the "Emergency Initiative" (Mark-Up-To-Market) were permitted to enter into contract renewals for five year terms. All other renewals, with the exception of short-term renewals under 514(c) (for projects being referred to OMHAR) and short-term renewals for the protection of the families (to allow time to issue vouchers in instances of Owner opt-outs), were renewed for one-year terms. In FY 2000, HUD has the authority to enter into Section 8 project-based contract renewals for any term.

- A. Generally, contract terms shall be for one or five years.
 1. If an Owner chooses a contract term of more than one year, the contract will be funded for one year with the balance of years selected by the Owner being subject to annual appropriations.
 2. The effective date of the new contract is the day following the expiration date of the previous contract.

Note: HUD will consider terms longer than five years on a case-by-case basis.

- B. HUD offices should make every effort to align contract renewal terms with the five-year life cycle of the RCS. For example, if an Owner renewed the contract in FY 99 under section 524(a)(1) for a one year term, and in FY 2000 the Owner wishes to renew the contract for a five year term, the Owner has two options:
 1. They may renew the contract for four years, using the RCS submitted at initial renewal (the 524(a)(1) renewal) and adjusting it by OCAF, or,
 2. They may submit a new RCS and renew the contract for a five year term.
- C. Short term contracts are for less than one year. The term "short term " refers to the term of the contract, not the "type" of contract.

Short-term renewals may be provided for the following:

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1. To protect the families. For example, to allow additional time to cover a delay in providing family based assistance in cases of Owner opt-outs, or in cases where the project is subject to enforcement actions.
 2. To align multiple contracts or stages in a project.
 3. To provide HUD with adequate time to process an Owner's request to renew under the Mark-Up-To-Market Procedure.
- D. For all projects, the short-term renewal will be considered to be the contract's "initial" renewal.
1. For Owners requesting a short term renewal under option 2, Owners must submit a RCS and all documentation required in Attachment 4 .
 2. For Owners requesting a short term renewal under option 4, Owners must submit all documentation required in Attachment 4. Renewal rents will be subject to the "lesser of" test in Option 4, at initial renewal only.

NOTE: Hub and Program Center Directors should use their discretion when determining whether or not to grant a short-term renewal.

- E. Where a short-term contract is executed:
1. It should be renewed in increments of months, not days,
 2. The project files should adequately document the need for the short-term renewal.

NOTE: For multiyear contracts, Owners must submit the worksheets found in Attachment 4 annually. If the Owner is requesting a budget-based rent increase, all documentation required in Attachment 4 must be submitted annually.

F. **Calculating Rents for Short-term renewals:**

Short-term renewals are for terms of less than one year. When executing short-term renewals using a

Section 524 contract, if the project is entitled to an OCAF increase, a pro-rated OCAF should be applied to the contract instead of a full OCAF. This is because the new law requires that an eligible project receive a rent increase at initial renewal, but does not entitle the project to more than one full OCAF increase within a 12 month period. Because the project will be entitled to a full OCAF increase at the first subsequent renewal with a term of one or more years, the OCAF increase for the short-term initial renewal must be pro-rated.

To calculate a pro-rated OCAF:

Take the full OCAF, divide it by 12 and multiply that number by the number of months needed for the short-term renewal.

Example:

Full OCAF: 2.5%

Months in Year: 12

Term of Short-term contract: 8 months

$2.5 \text{ divided by } 12 = .21 \times 8 = 1.68$

The Pro-rated OCAF to apply to the short-term renewal is 1.68%.

After determining the pro-rated OCAF, follow the instructions in Attachment 4 for applying the OCAF to the Section 8 units being renewed.

Note: This method of calculating the rents for short-term renewals is only for projects renewing under Section 524 of MAHRA, not for Section 514(c) renewals, nor generic contract renewals.

- G. From HUD's point of view, a desirable goal is to have only one Section 8 contract per project. To achieve this goal, Owners may elect to combine multiple contracts or stages. HUD cannot require Owners to combine contracts. However, the benefits of combining multiple contracts in the same project should be pointed out to Owners.
- H. At the Owner's request, multiple contracts or stages that are expiring in FY 2000 may be combined into one contract. This combination can be achieved in one of two ways:

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1. At the time of renewal of the first stage or contract, the Owner may request a short-term renewal to bring the earliest expiring contract in line with the latest expiring contract. If the Owner elects to do so, they must meet the appropriate renewal requirements. Only contracts that are at or below market or are exempt from OMHAR may take a short-term renewal to align contracts.

The first contract/stage should be renewed for the period of time necessary to bring it coterminous with the later expiring contract (remember, only contracts expiring in the same FY may be combined). The rent for the early expiration will be adjusted following the option selected by the Owner and supported by a RCS, if required. If OCAF is appropriate for the first contract, the rent will be adjusted by prorating the OCAF. (See above)

The pro-rated OCAF should be applied to the early terminating contract or stage and to the RCS. When the contracts or stages expire, they will be combined and renewed for the a minimum term of one year. If an OCAF adjustment is appropriate, the full OCAF should be applied to all the renewing units.

2. The Owner's second option would be to terminate the later expiring contract early, roll those units into the earlier expiring contract and renew all of the units for a one or five year term.
 - I. If an Owner has multiple stages or contracts that it does not want to combine, the contracts or stages that expire during the five year life cycle of the earlier RCS may use that earlier RCS at the initial renewal of the later expiring contract or stages. The RCS should be adjusted by OCAF, provided that the RCS included all of the Section 8 unit types in the project. If the Owner believes that rents have changed since the initial renewal, he/she may submit an updated RCS.
 - J. Attachment 4 includes a checklist format which can be used by Owners to request a contract renewal. The cover sheet of this format has a space for the Owner to designate its choice regarding the combination of multiple contracts or stages.

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- K. An exception to HUD's preference to combine contracts is when there are pre- and post-October 1, 1981 contracts involved. Due to conflicting income eligibility requirements for these two categories of contracts, it is not practical at this time to allow Owners to combine a pre-October 1981 contract or stage with a post-October 1981 contract or stage.
- L. Contracts and stages that expire in different fiscal years may not be combined during FY 2000. However, if an Owner requests a contract renewal to bring multiple contracts or stages in line so that they may be combined more easily in future years, HUD will permit this. An example would be a property which has a contract that expires in January 2000 and another that expires in March 2001. The Owner may request a 15 month renewal for the January 2000 contract to bring it coterminous with the March 2001 expiration.
- Rural Housing Service (RHS) has separate guidelines.
(See Section XXI)
- M. See Attachments 20, 21, and 22 for processing instructions when combining contracts.

VII. OWNER'S OPTIONS AT CONTRACT EXPIRATION

In FY 1999, MAHRA provided Owners with three options at contract expiration. Under the first option an Owner could elect to renew under Section 524(a)(1), or Section 524(a)(2). Section 524(a)(1) required Owners to conduct a RCS and limited renewal rents to comparable market levels. Section 524(a)(2) allowed renewals for "exception" projects. These projects were ineligible for OMHAR, and as such, they renewed without having to conduct a RCS (except for projects under 524(a)(2)(E)). Section 524(a)(2) projects renewed at the lesser of current rents adjusted by OCAF or a budget-based rent.

The second option Owners had was in cases where the Owner knew that contract rents exceeded comparable market rents or when the RCS indicated project rents were above comparable market rents. The Owner could choose to have the contract referred to OMHAR for a mortgage restructuring and/or a reduction of the rents to market.

The third option available to Owners was to opt out of the Section 8 contract.

During FY 1999, HUD implemented a fourth option, the Emergency Mark-Up-To-Market Initiative for certain projects.

In FY 2000, Owners have similar options available to them, including all of the options noted in the above paragraph. In addition, Preservation projects and Portfolio Reengineering Demonstration projects are treated differently in FY 2000. (See Section XXII)

HUD's general processing instructions can be found in Attachment 4A.

In FY 2000, Owners have the following options available to them at contract expiration:

OPTION 1: REQUEST RENEWAL UNDER THE MARK-UP-TO-MARKET PROCEDURE.

OPTION 2: REQUEST RENEWAL OF OTHER CONTRACTS WITH CURRENT RENTS AT OR BELOW COMPARABLE MARKET RENTS.

OPTION 3: REQUEST REFERRAL TO OHMAR:

- To reduce the Section 8 contract rents to comparable market rents without restructuring the mortgage (OHMAR-Lite).
- To restructure the mortgage and reduce the Section 8 contract rents to comparable market rents.

OPTION 4: REQUEST RENEWAL OF THE CONTRACT FOR PROJECTS EXEMPTED FROM OMHAR.

OPTION 5: REQUEST RENEWAL OF PORTFOLIO REENGINEERING DEMONSTRATION OR PRESERVATION PROJECTS.

OPTION 6: NOTIFICATION OF INTENTION TO OPT OUT OF THE SECTION 8 CONTRACT.

Note: *An Owner must submit its option at least 120 days before contract expiration*

VIII. Rent Comparability Study (RCS)

NOTE: *The procedures for conducting and reviewing the RCS are currently undergoing major revisions. These revised instructions will be published in the near future. Until they are published, the instructions for completing the RCS in Attachment 6 should be followed*

- A. Contracts that renew for the first time under Option 1 or Option 2 are required to submit a RCS. For the purpose of later contract renewals, the RCS is valid for a period of five years. Owners will be required to submit a new RCS at the end of the five-year term. If HUD believes that contract rents have significantly exceeded comparable market rents, HUD may request one updated RCS during the five year period.
1. An Owner must submit a RCS not less than 120 days before initial renewal.
 2. The RCS submitted at initial renewal must have been completed within 90 days of submission by the Owner to HUD.
 3. If the Owner's RCS concludes the Section 8 rents in the expiring contract(s) are less than market but the HUD reviewer (or the Contract Administrator) does not agree with the RCS, the Program Center Director or Hub Director will exercise their authority to accept or reject the RCS, utilizing whatever staff or other resources (including OMHAR) they feel appropriate for this purpose. If HUD rejects the Owner's submission, the Owner will be given the opportunity to appeal the decision under the Appeal Process included in Section XX.
 4. The RCS must include all Section 8 unit types in the project.
 5. For the purpose of later contract renewals, the RCS submitted at initial renewal is valid for a period of five years from the date of the initial renewal.
 - a. The initial RCS will be valid for any contracts or stages expiring during the five year term of the RCS. HUD will adjust the

RCS annually by the OCAF. Note also that the initial RCS may be used as the comparability standard for current or future budget-based rent increase requests.

- b. Projects that submitted a RCS last year do not need a new RCS because the renewal last year counts as the initial renewal. Use this same approach for the Demo projects.
 - c. A new RCS is required at the end of the five-year period.
- B. By law HUD has the authority to request (one time only) an updated RCS during the five-year life cycle.
 - 1. If the new RCS indicates that project rents:
 - a. Exceed comparable market rents, HUD may adjust the rents to the comparable market rents; or
 - b. Are below comparable market rents, HUD may increase project rents to comparable market rents, consistent with outstanding instructions for Mark-Up-To-Market (Option 1).
 - 2. HUD does not anticipate exercising this authority during the term of a multi-year contract.
- C. HUD staff must keep detailed records in REMS of which projects have completed the RCS. This information must include the date of the initial Section 8 contract renewal as it starts the five-year clock.

Note: When determining whether or not the expiring Section 8 contract rents are at or below comparable market rents, the results of the RCS should be considered in the aggregate (the total income generated by all market rents in the expiring Section 8 contracts/stages should be compared to the total income generated by the current Section 8 rents in the expiring Section 8 contract(s)/stages)

- D. If an Owner renewed the contract in FY 99 under section 524(a)(1) of MAHRA for a one year term, and in FY 2000 the Owner wishes to renew the contract for a five year term, the Owner has two options:

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1. They may renew the contract for four years, using the RCS submitted at initial renewal (the 524(a)(1) renewal); or,
 2. They may submit a new RCS and renew the contract for a five year term.

IX. OPTION 1: REQUEST FOR RENEWAL UNDER MARK-UP-TO-MARKET

An Owner may request to enter into Mark-Up-To-Market at any expiration of its Section 8 contract. Rents may be renewed at the lesser of comparable market rents or 150% of the FMR. The Owner can use an existing RCS adjusted by OCAF to establish initial eligibility.

A. Eligible Projects

All properties that meet the following criteria are eligible for a Section 8 contract renewal under Mark-Up-To-Market:

1. A Real Estate Assessment Center (REAC) physical inspection score of 60 or above with no uncorrected Exigent Health and Safety (EHS) violations.
2. For-profit or limited-distribution Ownership.
3. Comparable market rents at or above 110% of the FMR potential.
4. The project does not have a low-and moderate-income use restriction that cannot be eliminated by unilateral action by the Owner. (Examples would be the existence of a Rent Supplement Contract, prior or present Flexible Subsidy assistance, or Low-Income Housing Tax Credits.)

B. In addition to the qualifying criteria in A. above, HUD will use its discretionary authority to mark rents up to market to facilitate a change in Ownership from a for-profit Owner or limited-dividend Owner to a nonprofit; or from one nonprofit Owner to another nonprofit Owner.

1. To be eligible, a nonprofit Owner must have:

-
- a. Financial capacity;
 - b. Managerial capacity for owning and operating a multifamily project; and,
 - c. Ties to the neighborhood

Note: A nonprofit Owner may include a nonprofit-controlled limited partnership formed to obtain tax credits.

2. The property transferred does not have to meet criteria 1, 2, 3, or 4 in A. above. The transaction must result in a Use Agreement of at least 20 years, which includes affordability restrictions and a requirement to accept Section 8 renewals. If the project already has a Use Agreement, it must be extended an additional 20 years.
3. It is assumed that a project transferred to an eligible nonprofit based on the criteria in 1. above, is a high priority for the local community, and therefore meets criteria C.3. below as well. However, if a Field office believes the project does not meet any of the criteria in C. below, the Field Office may refuse to approve the mark-Up-To-Market request, or may refer the request to headquarters.

C. For projects that request participation in Mark-Up-To-Market but do not qualify under A. or B. above, or for projects that request an increase in rents above the cap on comparable rents of 150% of FMR, HUD will consider these requests if the project:

1. Has a high percentage of the units rented to elderly families, disabled families, or large families;
2. Is located in a low-vacancy area where family-based vouchers would be difficult to use and there is a lack of comparable rental housing; or
3. Is a high priority for the local community as demonstrated by a contribution of State or local funds to the property.

These requests will be considered waivers of this Notice and must be submitted to Headquarters as described in Attachment 4B.

- D. All Owners that are renewed under Mark-Up-To-Market must accept a five-year Section 8 contract subject to annual appropriations. In years two through five, rents will be adjusted by OCAF; HUD does not anticipate approving budget-based increases because they would take rents above the OCAF-adjusted comparable market rents. HUD does not anticipate requiring Owners to provide an updated RCS during the term of the contract.

Note: If the Owner or Purchaser of the project has engaged in material adverse financial or managerial actions or omissions with regard to the project; or the Owner or Purchaser has engaged in material adverse financial or managerial actions or omissions with regard to other projects of such Owner or purchaser that are federally assisted or financed with a loan from, or a mortgage insured or guaranteed by, an agency of the Federal Government, he/she is ineligible for participation.

- E. For processing instructions, please see Attachments 4B and 4C.

X. OPTION 2: REQUEST RENEWAL OF OTHER CONTRACT WITH CURRENT RENTS AT OR BELOW COMPARABLE MARKET RENTS

Option 2 is for Owners who request a renewal of their Section 8 contract where the RCS indicates that the contract's current rents are at or below comparable market rents, but are not applying for Mark-Up-To-Market.

A. Rent Adjustments.

1. At initial renewal the current rents:
 - a. Shall be adjusted by:
 - 1) An OCAF; or
 - 2) At Owner's request, by budget-based increase.

-
- b. Initial renewal rents may not exceed the comparable market rents.
 2. At subsequent renewal the current rents may be adjusted by:
 - a. An OCAF, or
 - b. At the Owner's request, a budget-based increase, as long as the resulting rents are below the OCAF-adjusted RCS discussed in section VIII. A. 5. a.. If the rents are above the RCS, HUD will not approve the budget-based request.

Note: In no case shall application of OCAF result in negative rent adjustments.

- B. For Initial Renewals, the Owner submits:
 1. Attachment 4, Owner's Option Checklist and Worksheet;
 2. A RCS prepared following Attachment 6; and
 3. If applicable, a budget-based rent increase request in accordance with the requirements of HUD Handbook 4350.1, Chapter 7, and Attachment 8 (Owner Distribution Worksheet).

NOTE: Unlike Owners who participate in Mark-Up-To-Market, Owners who have rents brought up to market via application of OCAF or a budget-based rent increase are not required to renew for five years.

- C. For subsequent renewal years two through five, the Owner submits:
 1. Attachment 4, Subsequent Renewal Request; and
 2. If applicable, a budget-based rent increase request in accordance with the requirements of HUD Handbook 4350.1, Chapter 7, and Attachment 8 (Owner Distribution Worksheet).

NOTE: Where a contract receives an OCAF rent adjustment, a proportionate amount of any OCAF-adjustment to the rent must be applied to the reserve for replacement account.

XI. OPTION 3: REQUEST REFERRAL TO OMHAR

In FY 2000, eligible above market contracts are to be referred to OMHAR for processing.

A. The Owner of an eligible above market project

1. Requests either:

- a. A renewal of the contract without restructuring, with the rents marked down to market (see OMHAR-Lite below); or
- b. A mortgage or rent restructuring and contract renewal with the rents marked down to market.

NOTE: No matter what renewal option an Owner selects, if HUD determines that contract rents exceed comparable market rents and the project is eligible for OMHAR, the Field Office or Contract Administrator must forward the project to OMHAR for processing.

2. Submits the worksheet including a certification that project rents exceed comparable market rents and neither the Owner nor any affiliate is suspended or debarred. If the Owner or any affiliate is suspended or debarred, the project may continue to be eligible for restructuring at OMHAR's discretion.

B. OMHAR Processing.

Further information can be found in the Mark-To-Market Program Operating Procedures Guide, (Section 10-4) which addresses processing OHMAR-lites and rent renewals without debt restructuring. The Guide can be found on the Web at:

www.hud.gov/omhar/readingrm/opglinks.html.

NOTE: An Owner may request that contracts with out-year (later than FY 2000) expirations be forwarded to OMHAR for restructuring.

XII. OPTION 4: REQUEST RENEWAL FOR PROJECTS EXEMPTED FROM OMHAR

Certain project types cannot be forwarded to OMHAR even though the contract rents may exceed market.

A Section 524(b) authorizes renewals for the following "Exception" projects:

1. Projects for which the primary financing or mortgage insurance was provided by a unit of State government or a unit of general local government (or an agency or instrumentality of either) and is insured under the National Housing Act; and where a mortgage restructuring and rental assistance sufficiency plan conflicts with local law, or agreements governing such financing;
2. Projects financed under Section 202 of the Housing Act of 1959 or Section 515 of the Housing Act of 1949 (includes 202/8, 515/8; does not include 202 and 811 Capital Advance projects, which do not have Section 8 contracts);
3. Projects that have an expiring contract under Section 8 of the United States Housing Act of 1937 pursuant to Section 441 of the Stewart B. McKinney Homeless Assistance Act; (SRO Mod Rehab) and
4. Projects that do not qualify as eligible multifamily housing projects pursuant to Section 512(2) of MAHRA. Examples include:
 - a. a project that is not subject to a HUD-held or insured mortgage; or,
 - b. a project that has FHA mortgage insurance or is HUD-held with rents at or below comparable market rents.

NOTE: For an Owner of an FHA-insured or HUD-held project to claim eligibility under 4b, they must obtain a RCS.

For projects listed above, the statute permits them to renew under renewal options one or two, as well.

B. For Initial Renewal:

1. The Owner should submit:

-
- a. Attachment 4, Owner's Option Checklist and OCAF Worksheet - Initial Renewal.
 - b. Budget and rent schedule completed in accordance with the requirements of HUD Handbook 4350.1, Chapter 7, and Attachment 8.
 - c. For an FHA-insured or HUD-held project that is requesting renewal as described in Section A4 above, a RCS showing that the project's current rents are at or below comparable market rents is required.
2. The rents at initial renewal will be the lesser of:
 - a. The project's current rents adjusted by an OCAF; or
 - b. The budget-based rent provided in the format required by HUD Handbook 4350.1, Chapter 7 and Attachment 8, and submitted with the request for renewal.

NOTE: If the project had a budget approved by HUD less than one year before this process, a copy of that budget can be submitted in lieu of a new budget. There will be no increase. However, if the project Owner feels that a rent increase is necessary, a new budget-based rent increase request may be submitted with the request for contract renewal.

- C. For subsequent Renewal.

The Owner should:

1. Submit Attachment 4, Owner's Option Checklist and Worksheet-Subsequent Renewal; and
 2. Request either:
 - a. An OCAF-adjusted rent increase or
 - b. A budget-based rent increase.
- D. HUD will not allow Owners who renew under this option to include new debt (i.e., refinancing or including new

debt service in budget) that keeps or takes the project rents above market.

**XIII. OPTION 5: REQUEST RENEWAL OF PORTFOLIO REENGINEERING
DEMONSTRATION OR PRESERVATION CONTRACT**

A. PORTFOLIO REENGINEERING DEMONSTRATION PROJECTS

Projects that went through the Portfolio Reengineering Demonstration Program will renew the Section 8 contract in one of the following ways:

1. Projects that went through the Portfolio Reengineering Demonstration Program and had their mortgages restructured and/or had rents reduced to market should not be forwarded to OMHAR. They should be renewed as follows:
 - a. Annually for the four years after the Demonstration Contract was signed, the contract will receive an OCAF adjustment.
 - b. At the end of the fifth year, the project must follow the procedures outlined in Section X (option 2) of this Notice. This includes having to complete a RCS.
2. If the mortgage was not restructured and the project's rents were not reduced to market, the Owner must submit rationale as to why debt restructuring is inappropriate. The rationale and the renewal request should be submitted to Headquarters, Office of Portfolio Management, attention Frank Malone.

Processing instructions for Demonstration Projects can be found in Attachment 4.

B. LIPHRA and ELIHPA (PRESERVATION PROJECTS)

When Owners entered into long-term use agreements with HUD under the Preservation Program, HUD agreed to certain items (outlined in the Preservation property's approved Plan of Action (POA)). In FY 1999, Preservation projects were not included as exception projects under MAHRA and as such, they were limited to Section 8 contract renewals under Section 524(a)(1).

In many cases, a renewal under 524(a)(1) would have resulted in rent reductions for the contract. In a majority of Preservation contracts, the POA allows for either a budget-based rent adjustment or an Annual Adjustment Factor (AAF) rent adjustment. MAHRA limited rent adjustments to OCAF for all 524a(1) projects and as such, Preservation Owners were denied the benefits called for in the POA. This situation has been rectified for FY 2000 by new legislation.

1. Preservation projects shall be renewed (both at initial and subsequent renewal) according to all provisions outlined in the project's POA.
2. There are instances where the Owner of a Preservation project has renewed a contract in the past under terms different than the terms in the approved POA. In these cases field offices should calculate what the rent would have been if the contract(s) had been renewed consistent with the POA. This is the rent that should be used as the basis for determining the renewal rent for FY 2000. There will be no reimbursement for income lost because of past renewals.
3. In general, most POAs did not permit the Owner to opt out of their Section 8 contract. However, if a Preservation project Owner does elect to opt out of the Section 8 contract or prepay:
 - a. The Owner must give HUD a detailed plan indicating how it intends to honor its obligations under the Use Agreement to maintain the project as affordable housing.
 - i. This plan should detail how the Owner intends to maintain the appropriate income mix.
 - ii. The plan should be submitted to Frank Malone, Director, Office of Portfolio Management, Headquarters, for review.
 - b. The Hub or Program Center should take the following steps:
 - i. The PM should review the POA to determine if it provides the right for the Owner to opt out of the Section 8 contract. In general, opt-outs were

precluded, but each Preservation POA was structured differently, and as a result, field offices will have to review each POA and Use Agreement to determine whether or not the project is eligible to opt out of the Section 8 contract.

ii. If the POA does not allow the Owner to opt out, the Field Office should advise the Owner that they must renew the Section 8 contract.

iii. If the POA allows the Owner to opt- out, eligible families will be issued enhanced vouchers.

NOTE: Owners must be made aware that should they elect to opt out or prepay, it does not release them from their obligations under the long-term Use Agreement to provide affordable housing.

Processing instructions for ELIHPA and LIHPRHA Preservation Projects can be found in Attachment 4.

XIV. OPTION 6: NOTIFICATION OF INTENTION TO OPT OUT OF THE SECTION 8 CONTRACT

HUD is committed to preserving affordable housing. Local Offices should make every effort to inform Owners of all available options, including Mark-Up-To-Market. However, if an Owner chooses to opt out of the Section 8 contract, and has satisfied the relevant Notification requirements, the Owner may request to opt out of the Section 8 program by providing the Cover Sheet format in Attachment 4 and the Worksheet for Option 6. (This is done for HUD's convenience to assist in providing vouchers to eligible families.) The request must be sent to the Director of the Multifamily Program Center or Hub which has jurisdiction over the project 120 days prior to contract expiration. The PM should ensure that the Owner has no restriction from opting out, for example, Preservation properties, Portfolio Reengineering Demonstration properties, etc.

XV. PROTECTING SECTION 8 FAMILIES

A. The Department is committed to protecting families living in assisted units, regardless of the actions a project Owner may take. To protect families living in assisted units, HUD will make vouchers available in the

event project-based assistance ends as a result of a "Housing Conversion Action."

Section 538 of the FY 2000 Appropriations Act enables the Department to make enhanced vouchers available to limit the displacement of families living in an assisted unit when an Owner elects to opt out of the Section 8 project-based program. As has been the case when enhanced vouchers were provided in prepayments, residents may elect to remain in their units when issued an enhanced voucher as a result of an opt-out.

1. The following actions constitute the "Housing Conversion Actions":

- a. Project-based opt-outs. This term refers to a conversion action where an Owner chooses to opt out of certain programs by not renewing an expiring Section 8, Section 23, or rent supplement program project-based contract. Commencing in FY 2000 and subject to the availability of appropriations, enhanced vouchers are provided for the eligible residents who were assisted under the expiring project-based contract on the date of expiration.
- b. HUD enforcement actions. In these cases, HUD is either terminating the Section 8 project-based HAP contract or not offering the Owner the option to renew an expiring contract due to an Owner's failure to comply with the terms of the HAP contract.

HUD enforcement actions may also result from material adverse financial or managerial actions or omissions which lead to either Owner default under a FHA-insured mortgage (monetary or technical) or a documented material violation of one or more of the obligations under the project's Regulatory Agreement.

Regular housing choice vouchers will be provided in these circumstances to assist eligible families affected by the enforcement action.

- c. HUD property disposition (PD). In these cases HUD is the mortgagee-in-possession or

Owner of the multifamily property due to an Owner default on an FHA-insured mortgage and is closing down or selling the property to a new Owner. Regular housing choice vouchers will be provided to assist eligible families in these cases.

2. The payment standard for enhanced vouchers is based on comparable market rents, and will be detailed in a joint Housing and PIH Notice which is forthcoming.
 3. To qualify for tenant-based assistance, the family must live in an assisted unit on the date of the contract expiration, be income-eligible and otherwise eligible to participate in the tenant-based Section 8 program.
 4. Once the family moves from the project, the enhanced feature is no longer in effect and the voucher reverts to a standard housing choice voucher.
- B. HUD is in the process of issuing a Notice on Section 8 Tenant-Based Assistance for Housing Conversion Actions in FY 2000. The Notice will outline policies and processing guidelines for administering vouchers. For more information contact the local PIH Office.
- C. The process of converting to tenant-based assistance can produce worry and fear for many families. Therefore, care must be taken to make sure the process is completed correctly and information is made clear and available for all families, Owners, and PHAs. If there is any delay in processing the tenant-based assistance, the Department may ask the Owner to consider a short-term renewal of the contract.

XVI. OWNER'S NOTIFICATION REQUIREMENTS

- A. The FY 2000 Act requires that, at least one year prior to contract termination or expiration, the Owner must give a written notice to tenants and HUD of the contract's expiration.
- B. Reminder Letter to Owners. Attachments 3A and 3B are letters to Owners from HUD reminding them of their notification responsibilities. The letters have been slightly modified from previous versions and field staff will have to continue issuing these letters as

they have in the past. Headquarters will notify the field if there are any changes in this process.

C. Content of Notification Letter. Attachment 3C provides Owners with a sample one-year notification letter when an Owner intends to opt-out of the Section 8 project-based contract. Attachment 3D provides Owners with a sample one-year notification letter when an Owner intends to renew the Section 8 project-based contract.

1. The Department encourages Owners to utilize a letter similar to the sample ones provided in this Notice.
2. Owners are no longer required to specify the reasons for contract termination. However, Owners are encouraged to provide as much information as possible to the residents.

3. The notification must include a statement that:

"If the Congress makes the funds available, the Owner and the Secretary may agree to a renewal of the contract, thus avoiding termination, and that in the event of termination, HUD will provide tenant-based assistance to all eligible residents, enabling them to choose the place they wish to rent, which is likely to include the dwelling unit in which they currently reside."

4. Project Managers in the field must review all Tenant Notification letters to ensure that they are consistent with the new FY 2000 law. If the letter is not in compliance with the new law then it should be returned to the Owner for corrections.

NOTE: For purposes of determining when the one year notification clock begins, if HUD returns the letter to the Owner for corrections, the clock does not start until the corrected letter is provided to HUD and the tenants.

D. In general, upon execution of a short-term contract, the Owner must provide a one-year notification to tenants and HUD. Over the course of this one-year period, the Owner and HUD may agree to additional short-term extensions. The Owner is not required to provide a new notice as each subsequent short-term extension is granted. Instead, the Owner will have

fulfilled his/her requirement if he/she was provided a short-term extension, and the 12 months have elapsed. If the Owner accepts another short-term renewal after the 12-month notification period has expired, the Owner will be subject to another 12-month notification requirement. Exceptions to this general policy are as follows:

1. Where the Owner has fulfilled his/her notification requirement, but agrees to execute a contract for less than one year solely to provide HUD with enough time to provide Section 8 tenant-based assistance, execution of a short-term contract does not require a notice requirement.
2. Where HUD provides the Owner with a short-term contract to cover the remaining portion of the notification period (i.e., the Owner provided a 12-month notice, but at a time when the contract had fewer than 12 months remaining), execution of a short-term contract does not trigger an additional notification requirement. However, the original 12-month notice must make clear that the Owner may not raise the tenant's portion of the rent, independent of the contract expiration date, until the full twelve months have passed since notification was provided.
3. Where an Owner provided tenants and HUD with the proper notification and then accepts a short-term renewal to consider accepting a Section 8 contract under the terms of Mark-Up-To-Market, the Owner would not be subject to another one-year notification requirement.

E. Selection of Option at Contract Expiration.

Four months (120 days) before the contract expiration, Owners are asked to notify HUD's local Hub or Program Center Director in writing that they are going to renew or opt-out of their Section 8 contract. HUD needs this time to obtain enhanced vouchers for the eligible families living in the assisted units.

F. Prepayment of Preservation Eligible Properties.

Section 219 of the Quality Housing and Work Responsibility Act of 1998 established a notification requirement for Owners of ELIPHA and LIHPRHA eligible projects that elect to prepay their federally-assisted mortgages. At least 150 days, but not more than 270 days, before the date of prepayment, Owners must provide written notification to the families and HUD of their intent to prepay. A sample letter is available as Attachment 3E of this Notice.

G. Other Requirements.

Besides meeting the Federal notification requirements, project Owners must also comply with any State or local notification requirements. Owners should check with their appropriate local authorities to find out about such requirements.

H. Failure to comply with Section 8 Opt-Out Notification Requirements.

If an Owner fails to provide the one-year written notice to HUD and the families, legally, the Owner must permit the families to remain in their unit without increasing the family's portion of the rent for one year after the Owner gives the required notification.

XVII. LEASE ADDENDUM

- A. Attachment 5 contains a Lease Addendum with Termination of Tenancy provisions which address the one-year contract termination and Owner notification requirements.
- B. The appropriate contract addendum should be executed according to the following schedule:
 - 1. When a new family moves into the project.
 - 2. Upon expiration of the family's original one-year lease.
 - 3. Upon receipt of the Owner's one-year family notification in accordance with Section 8(c)(8)(A), and the family has lived there more than one year.

XVIII. RESIDUAL RECEIPTS

- A. Disposition of the Residual Receipts Account Upon Termination of the Section 8 Housing Assistance Payments (HAP) Contract or Upon Owner Opt-Out.

Owners are reminded that under the regulations for Section 8 New Construction (effective November 5, 1979), Substantial Rehabilitation (effective February 28, 1980), and State Agency (effective February 28, 1980) projects, for Section 8 assisted projects as defined by 24 CFR 880.201 or 883.302, as applicable, when the HAP contract terminates, HUD has the right to require the designated Depository to return to HUD the unused balance of funds remaining in the Residual Receipts Account at the time of the HAP contract's termination.

- B. HAP Contracts where the Mortgage Insurance is Terminated by the Owner before Termination of the HAP Contract.

Should an Owner elect to prepay the mortgage before termination of a HAP Contract and the Owner has a 100 percent subsidized HAP Contract under the new regulations, any balance remaining in the Residual Receipts account at the time of the insurance termination must continue to be held in trust by a Depository and under the control of HUD. Upon expiration of the contract under this Notice, these funds must be remitted to HUD.

- C. Notification Requirements.

The Hub or Program Center Director must notify the Section 8 Financial Management Center and the Fort Worth Accounting Center once an Owner's decision to opt out is final or HUD terminates any Section 8 HAP Contract.

1. Any remaining subsidy, as well as funds in an applicable Residual Receipts account must be returned to HUD.
2. The Hub or Program Center Director should send a memorandum to the Comptroller, Fort Worth Accounting Center, informing the Comptroller of the termination of the Section 8 HAP Contract(s)

and any impending deposit of remaining funds in a Residual Receipts Account by a depository.

- a. Include documentation to evidence the termination of the HAP Contract with the memorandum.
 - b. Simultaneously, send a letter of instructions to the Depository advising them of the disposition of the Residual Receipts Account.
3. The Depository must forward all remaining or prorated funds held in the Residual Receipts Account to a Lockbox administered by NationsBank of Georgia, P. O. Box 277303, Atlanta, GA 30384-7303. It is **critical** that the Section 8 contract number(s) be disclosed on the front of the check so that the funds can be returned to the proper HAP Contract or else the Lockbox will not know where to place the funds.
 4. Once the Fort Worth Accounting Center receives confirmation of the termination of the HAP contract(s), all of the funds remaining in the Lockbox will ultimately be sent to the Budget Office in HUD Headquarters for recapture.

XIX. PHYSICAL CONDITION OF THE PROPERTY

- A. The physical condition of a property is an important component in deciding whether or not to renew a Section 8 contract. The Real Estate Assessment Center (REAC) will complete a physical inspection that will assist field staff in making this important decision. Based on the results of the inspection, HUD can either renew, terminate or simply let a contract expire. The vast majority of properties will not show serious problems and will have their contract renewed. However, some properties will be shown to be in material violation of their agreements with HUD. The course of action that the field staff will take will depend on the score the property receives on the report and whether the Owner corrects the deficiencies in an acceptable and timely manner.

In cases where there are multiple contracts or stages on one property, there will only be one inspection each year. The PM should refer back to the results of the earlier inspection and the Owner's response. If the

Owner submitted a Plan to complete the repairs, as described below, the PM should assess compliance with that Plan when making a recommendation on renewing the contract. If in the Owner's plan, it is not determined that the repairs have or will be made, or if the Owner is not in compliance with the approved plan, the contract should not be renewed. (If a contract is not renewed or terminated, See Section XIX D.)

- B. An Exigent Health and Safety (EHS) Deficiency Notice or a Full Physical Inspection Report from REAC may affect renewals of Section 8 HAP contracts.

1. EHS Deficiency Notice

Field staff should not take action to terminate the contract or refuse to renew the contract based solely upon receipt of the EHS Notice. However, if the condition is not promptly corrected or mitigated, the Section 8 subsidy should be abated on individual units depending on the severity of the deficiency. Abatement on units identified on the Deficiency Notice should occur only if the units are clearly identified, the deficiency is deemed exigent and the Owner cannot or will not repair or mitigate the problem. However, if EHS deficiencies are numerous and are not quickly corrected (within 72 hours) the Field Office should give careful consideration to not renewing the contract in addition to abating the Section 8 on individual units and or the field should consider requesting an expeditious special inspection from Headquarters to quickly determine the extent of the EHS problem throughout the project. A special inspection can be ordered within 30 days.

2. Full Physical Inspection Report (REAC)

Upon receipt of a full inspection report the Field Office has a complete picture of the condition of the property; and, subject to the Owner's response to the inspection, is prepared to assess how to handle renewal of the Contract.

- a. For inspections where the score is 60 or above:

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- 1) Renew the contract if all EHS deficiencies were corrected or mitigated; and
 - 2) If the Owner does not correct EHS, follow the procedures listed in (D) below.
- b. For inspections where the score is 59 or below:
- 1) And if all EHS deficiencies and repair items have been corrected or mitigated or the Owner submits an acceptable repair Plan within the prescribed time, renew the contract. If the repair Plan continues into the term of the new contract, the Owner must agree to execute the new HAP Addendum (See Attachment 18) regarding physical conditions in addition to the Plan.
 - 2) Whenever the Owner fails to complete the EHS repairs or provide an acceptable Plan for other repairs, and either the Owner indicates that it cannot or will not bring the property into compliance or the PM is certain that based on what the Owner has submitted as a Plan that the Owner cannot bring the property into compliance, generally, do not renew the contract.

However, the decision to not renew the Contract will depend on whether there is sufficient time to obtain vouchers to protect the residents.

- C. Any decision not to renew a Contract or terminate must be made by the Program Center Director or a Supervisor in the Hubs. Generally, the decision should be to not renew if serious physical problems exist at the property that threaten the health and safety of the families, unless the Owner has a viable plan underway and is current under that plan. The Hub Director must be informed before any termination in order to advise Headquarters of the potential termination. Every effort should be made to obtain compliance from the Owner. The PM should continue to actively service the asset to correct the physical problems of the property

up until the time the vouchers are about to be issued. The PM should utilize all resources that are available to restore full compliance, including the proposed sale of the property to a new Owner (Transfer of Physical Assets). A supplemental site visit is advisable as well as involvement of the Community Builder to address local issues. Appeals regarding any decision should go to the Hub Director.

D. The process to obtain vouchers to assist residents is expected to take no more than 180 days.

1. If more than 180 days remain on the contract:

- a. Notify the Owner that because the EHS repairs were not corrected or the Owner did not submit an acceptable Plan, HUD intends to not renew the Contract.
- b. Follow Attachment 7, to immediately begin processing vouchers; however, allow up to 180 days.
- c. Monitor the processing of the vouchers with the Owner, PIH and the assigned Public Housing Agency (PHA).

2. If less than 180 days remain on the contract.

- a. Notify the Owner that because the physical condition of the property remains uncorrected, HUD intends to end the project-based subsidy. However, to protect families in the interim, HUD is renewing the contract on a short-term basis (not to exceed 180 days) in order for HUD to process vouchers for residents. The Owner must also sign the new HAP Addendum.
- b. Do not sign the contract renewal with the Owner immediately.
 - 1) Make all necessary preparations to get funding for housing vouchers in place.
 - 2) Do not sign the renewal Contract with the Owner until very near the expiration of the existing contract.

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- c. Enter into a short-term renewal of the contract utilizing either of the appropriate generic contracts, at current rents, not to exceed 120 percent of Fair Market Rent (FMR).
 - d. Follow Attachment 7, in order to obtain the vouchers, allowing up to 180 days, if necessary.
 - e. Terminate the contract after vouchers have been issued to eligible families and sufficient search-time has been provided to locate eligible housing units with the tenant-based assistance.

3. HUD's decision not to renew:

- a. If the Contract is about to expire and the Owner appeals the decision to not renew the contract under this notice, the PM should renew the contract for one year ***with the new HAP Addendum, pending the appeal.***
- b. If the Owner subsequently becomes compliant or prevails with the appeal and the Field Office changes its decision, leave the contract in place.
- c. If the Owner does not prevail in the appeal, request vouchers to protect the families and coordinate with PIH. Terminate the Contract after vouchers have been issued to the eligible families and sufficient search time has been provided to locate eligible housing units with the family-based assistance.
- d. Should an Owner want to appeal the physical Inspection upon which certain decisions were made, see the Instructions for the Field for REAC Inspections.

E. REMS and Reporting Requirements

- 1. All activities related to bringing a property into Regulatory and Contractual compliance because of a REAC physical inspection must be entered in the Project Action Screen of REMS.
 - a. It is important to Owners for HUD to document compliance since that is part of the asset

management record which may influence future decisions; and it is important to HUD to have an accurate administrative record should HUD proceed with enforcement.

- b. Track in REMS all close-out activity regarding Physical Inspections.
2. The Hub Director must submit Attachment 19, Anticipated Abatement or Termination of Full Section 8 HAP Contracts on a monthly basis to Frank Malone, Director of Portfolio Management, Headquarters.
- a. The report will be used to track the number of anticipated abatements or termination of full Section 8 Contracts, as well as to identify Owners and the properties within a particular Hub or Program Center which may have abatements of Section 8 subsidy.
 - b. The Hub Director **must** contact Frank Malone before the actual termination of any full contract.

XX. HUD'S REFUSAL TO RENEW A SECTION 8 CONTRACT

- A. Under Sections 516 of and 524(a)(2) of MAHRA:
- 1. HUD may refuse to renew a contract if it is determined that:
 - a. The Owner or Purchaser of the project has engaged in material adverse financial or managerial actions or omissions with regard to such project; or
 - b. The Owner or Purchaser of the project has engaged in material adverse financial or managerial actions or omissions with regard to other projects of such Owner or purchaser that are federally assisted or financed with a loan from, or mortgage insured or guaranteed by, an agency of the Federal Government;
 - c. The project does not meet the physical condition standards for HUD housing that is decent, safe, sanitary, and in good repair,

unless HUD determines the project will meet the standards within a reasonable time after renewal.

2. Material adverse financial or managerial actions or omissions include:
 - a. Materially violating any Federal, State, or local law or regulation with regard to this project or any other federally assisted project, after receipt of notice and an opportunity to cure;
 - b. Materially breaching a contract for assistance under Section 8 of the United States Housing Act of 1937, after receipt of notice and an opportunity to cure;
 - c. Materially violating any applicable regulatory or other agreement with the Secretary or a participating administrative entity, after receipt of notice and an opportunity to cure;
 - d. Repeatedly and materially violating any Federal, State, or local law or regulation with regard to the project or any other federally assisted project;
 - e. Repeatedly and materially breaching a contract for assistance under Section 8 of the United States Housing Act of 1937;
 - f. Repeatedly and materially violating any applicable regulatory or other agreement with the Secretary or a participating administrative entity;
 - g. Repeatedly failing to make mortgage payments at times when project income was sufficient to maintain and operate the property;
 - h. Materially failing to maintain the property according to housing quality standards after receipt of notice and a reasonable opportunity to cure; or
 - i. Committing any actions or omissions that would warrant suspension or debarment by the Secretary.

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3. The Owner or Purchaser of the property materially failed to follow the procedures and requirements of MAHRA, after receipt of notice and an opportunity to cure.

B. Owner's Dispute and Appeal of Rejection.

If HUD refuses to renew an Owner's request for contract renewal, the following appeal process should be followed. However, HUD staff should take all steps necessary to protect the families. If this means executing a short-term contract to complete the appeal process and issue vouchers if necessary, that is what should be done.

1. HUD will provide a notice to the Owner giving the reason(s) for rejection.
2. The Owner has 30 calendar days from receipt of this notice to provide written objections or cure the problems identified. If the Owner does not submit written objections or cure the problems identified during that period, the decision will become a final determination under Section 516(c) of MAHRA and is not subject to judicial review.
3. If the Owner submits written objections or asserts that the problems identified have been cured, HUD will consider the matter, review the Owner's action, if any, and send the Owner a final decision affirming, modifying, or reversing the rejection and setting forth the rationale for the final decision.
4. Within 10 days of receiving the final decision, the Owner may submit a written appeal to HUD contesting the decision and requesting a conference to discuss the issues with the Hub that has jurisdiction over the project.
5. A representative of the Hub will meet with the Owner at a mutually agreeable time, but no later than 10 calendar days after request by Owner for meeting.
6. If the Owner wants to provide additional information, establish a mutually agreeable deadline for submission of the material.

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7. Within 20 days after the conference, or 20 days after any agreed-upon extension of time for submission of additional materials, the Hub will advise the Owner in writing of the decision to either terminate, modify or affirm the original decision.
 8. HUD will designate an official to review any appeal, conduct the conference, and issue the written decision. The official designated will be one who was not directly involved in making the decision being appealed.

The reviewing official's decision is a final determination and is not subject to judicial review.

- C. The Hub Director must contact Frank Malone, Director, Office of Portfolio Management in Headquarters before the actual termination of any contract.

XXI. RURAL HOUSING SERVICE (RHS) 515/8 PROJECTS

- A. Owners of Section 515/8 projects who are requesting a contract renewal under Option 4 pursuant to 524(b) of MAHRA must submit their project budget approved by the Rural Housing Service. HUD staff are not required to review and approve these budgets. As long as the budget has been approved by RHS, the budget-based rent should be accepted by HUD. Their budget-based rent is the "basic" rent.
- B. During our negotiations with RHS staff on this process, we agreed to accept RHS-approved budgets reflecting the appropriate 8 percent allowable Owner's distribution on equity or any higher level as approved by RHS as an incentive to the Owner to prevent prepayment. (This is explained in RHS's administrative notice dated April 12, 1999)
- C. An Owner of a Section 515/8 project may receive a short-term renewal in order to align the project's accounting cycle with the anniversary date of the Section 8 HAP contract. The Owner should contact the local HUD office. The PM will issue a short-term contract covering the months between the end of the current HAP contract and the end of the current accounting cycle (December 31). Upon expiration of the short-term contract, the Owner will be eligible for

renewal under the provisions of MAHRA, as described above.

The short-term contract is the Initial renewal under both 524(a) and 524(b) of MAHRA. After the short-term contract expires, the first full subsequent renewal contract will be based on current rents adjusted by an OCAF or RHS-approved budget as described in Section XII of this Notice.

Note: RHS projects are exempted from OMHAR under 524(b)(1). Like all other 524(b)(1) projects, at initial renewal, they are subject to the "lesser of" OCAF or budget-based test.

- D. An Owner who has executed a HAP contract expiring on December 31st is requested to submit its request for renewal to HUD annually by September 1. The Owner may submit a non-approved budget at this time. The Owner should submit the RHS-approved budget to the local HUD Hub or Program Center no later than November 15.

The process of issuing short-term contracts in order to align the accounting cycle with the anniversary date of the HAP contract may begin during FY 2000, with the first full renewals under this process being in January 2001.

- E. After the loan with RHS has been paid in full, the Owner will submit its budget and request for contract renewal directly to HUD. The contract will be handled in accordance with HUD procedures for non-insured projects with Section 8 contracts. The budget should be completed in accordance with the instructions in HUD Handbook 4350.1. After the contract receives an initial renewal under either Sections 524(a) or 524(b) of the MAHRA, the Owner will receive OCAF adjustments in subsequent years, without submitting an annual budget, unless the Owner requests and the Secretary approves a budget-based increase. Owners who renew under Section 524(a) are required to submit a comparability study at the time of initial renewal and at the end of five years. HUD may also request that the Owner submit one additional comparability study within the five year period.

XXII. BUDGET-BASED RENT INCREASES FOR CAPITAL REPAIRS

- A. One of HUD's primary concerns is the long-term preservation of affordable housing. The Mark-Up-To-Market renewal option will accomplish this goal for many properties. Due to budgetary constraints, however, nonprofit Owners are generally prohibited from Mark-Up-To-Market because they are less likely to opt out of their Section 8 contracts. Yet many nonprofit-owned projects are in need of recapitalization to perform repairs that will preserve them for the long-term as affordable housing.
1. To address the physical condition of nonprofit projects, the Department will approve a Section 8 budget-based rent increase, not exceeding comparable market rents, for nonprofit projects to perform capital repairs that will maintain the financial and long-term physical viability of the project when current rents are not sufficient. This is the first time that a budget-based increase will recognize increased debt service to address the physical needs of the project.
 2. This new option is an addition to existing policy on budget-based rent increases and does not replace any existing options for Owners. Both for-profit and nonprofit Owners continue to be eligible for budget-based increases for standard operating expenses under existing guidance.
 3. If there are unassisted units in the project, the burden of the rent increase will be calculated on the Section 8 rents similar to the Mark-Up-To-Market procedure.
- B. To be eligible, a project must meet the following criteria:
1. The new Section 8 contract rents will not exceed comparable market rents based on the Owner's RCS.
 2. The project must have a REAC score of greater than 30.
 3. The budget-based Section 8 contract rent increase request must support the project needs.

C. Any one of the following project needs may be a basis for approving a Section 8 contract rent increase.

1. Capital needs (e.g., lead-based paint, energy efficient developments, etc.) including debt financing.
2. Provide a 6 percent return on initial equity as computed on Form HUD-2580, Maximum Insurable Mortgage.

Note: This procedure is in addition to the current budget-based instructions found in Chapter 7 of HUD Handbook 4350.1.

D. For a Section 8 contract rent increase request for capital improvements to be approved, the nonprofit Owner must provide:

1. A Comprehensive Needs Assessment (CNA), or other reports determined appropriate by the HUD Field Office staff, to confirm project's capital improvement needs.
2. A financing plan for funding the repair, replacement and major maintenance needs of the project. As part of the plan, the nonprofit Owner must raise at least 10 percent of the estimated repair costs from other funds.
3. An estimate of the initial deposit to the replacement reserve, if any, and the estimated monthly deposit to the replacement reserve for the next 10 years. In the tenth year the estimated monthly deposit will be recomputed to make sure it meets the project's estimated needs.

E. If the nonprofit Owner successfully seeks a HUD-insured loan (e.g., 241(a), 221(d), 223(f), etc.) to finance the capital improvements, HUD will refund one-half of the application fee at initial endorsement.

F. HUD will:

1. Process the rent increase at any time during the life of the Section 524 contract. The methodology for setting the maximum Section 8 rent permitted will be based on the Mark-Up-To-Market procedure. Specifically:

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- a. Comparable market rents are capped at 150% of the FMR.
 - b. For a property already receiving benefits from a below-market interest rate mortgage, for example a Section 236 project, the comparable market rents must be adjusted by an Interest Subsidy Adjustment Factor to reflect the value of the subsidy for the below-market interest rate mortgage. See worksheets contained in Attachment 4C to perform the calculations.
 - c. The tenants living in the unassisted units will not have their rents increased.
- 2. Withhold approval where the Ownership has neglected the project or has allowed below satisfactory non-performing management to continue.
- G. The nonprofit Owner must:
- 1. Agree to a use agreement, that will be recorded, requiring the current and future Owners to accept any Section 8 contract offered by the Department for the next 20 years.
 - 2. Agree to refund to HUD one-half of the reserve for replacements at loan termination.
 - 3. Be financially solvent and have no open or unresolved audit findings or findings from analyses of the audited annual financial statements.
 - 4. Be in compliance with the terms of the Regulatory Agreement, Note, and Mortgage and be current in debt service and all payments, including the Reserve Fund for Replacement.
 - 5. Submit a copy of a resolution of the Board of Directors authorizing the additional debt to be incurred to repair or rehabilitate the project.

XXIII. OTHER RENT INCREASES

- A. Rent increases for Sections 236 and 221(d)(3) BMIR Projects.

These projects traditionally have used the budget-based method for all rent increases. Under the new law, Section 8 rents are renewed under the option selected by the Owner. However, unassisted units continue to follow Chapter 7 of HUD Handbook 4350.1.

HUD may approve a short-term renewal to permit Owners to bring into alignment the Section 8 contract renewal process and the submission of the annual budget-based rent increase.

B. Other rent adjustments

1. Normally all rent adjustment requests should be made on an annual basis. These requests should be submitted to HUD at least 60 days prior to contract anniversary date.
2. On a case-by-case basis, the Field Office may permit a rent adjustment more than annually due to unusual circumstances.

XXIV. REMS REPORTING.

- A. Enter the initial renewal date in the REMS system as "Expiration Date Causing Initial Renewal Pursuant to MAHRA."
- B. For example, a project has one contract that expired June 30, 1999. This contract received its Initial Renewal on July 1, 1999, using a 524(a) contract for a one-year term. The "Expiration Date Causing Initial Renewal Pursuant to MAHRA" which is entered in the REMS system for this project is June 30, 1999. In this case, when the contract is renewed on July 1, 2000, this will be a Subsequent Renewal. HUD Field Offices should use the Real Estate Management System (REMS) to track the progress of the project up to, and including when it is sent to OMHAR. Once the request is turned over to OMHAR, its tracking system will be used to monitor the progress of the request and feed back reports to REMS.

NOTE: HUD is considering providing access to REMS for Section 8 Contract Administrators.

XXV. FOR FURTHER INFORMATION.

- A. Section 8 Renewal Help Desks have been established in each Hub and certain Program Centers to provide technical assistance to Project Owners, managers and contract administrators who have questions regarding the Section 8 contract renewal process. Attachment 10 includes a complete list of all Section 8 Renewal Help.
- B. Information is also available on the following HUD web pages:
 - 1. The Multifamily Business Page:
<http://www.hud.gov/fha/fhamf.html>
 - 2. HUDCLIPS: <http://www.hudclips.org>
- C. To ask a Section 8 question regarding expiring contracts, write to:
sec_8_expiring_contracts@hud.gov
- D. To read the Section 8 questions:
<http://www.hud.gov/fha/mfh/mfhsec8.html>

Note: The requirements outlined in this Notice may not be waived by the Hub or Program Center Director.

Assistant Secretary for Housing - Federal Housing Commissioner